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China CITIC Bank

London Branch

Market Risk Management Policy

Document History

Author	Chief Risk Officer	**Status**	Final
Version	1.1	**Date**	October 2018
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Version	Owner	Approval	Date	Major changes
1.0	President	President	May 2018	PRA Regulatory Business Plan
1.1	CRO	MANCO	Oct 2018	• Add Governance & Risk Management Framework (4) • Delete 'Committee Structure and Risk Governance' – GRMF (6) • Limit Structure – add FX 'Stop Loss Limit' (6.2) • Interest Rate Risk - Add 'Gapping Limits' (6.3) • Add 'Review and Update of Policy' (10) • Add 'Appendix A – Market Risk Limits, Risk Appetite (11)

Content

1 Introduction

This purpose of this policy is to set out China CITIC Bank London Branch's ("CNCBLB" or the "Branch") approach to Market Risk and how it supports compliance with the Risk Appetite.

The Market Risk Management Policy (the "Policy") defines and identifies the Market Risk factors faced by the Branch including the risks arising from Foreign Exchange ("FX") trading, interest rates and hedging activities by CNCB LB Financial Markets.

Any changes to the regulated activities by the Branch would be subject both to approval through in accordance with the New Products Approval policy and regulatory notification and/or approval (depending on the ability carry out the planned activities under the current Part IV Permission).

All trading activities by CNCBLB will be conducted in accordance with UK regulations.

2 Objectives

The overarching objectives of the Policy is to ensure appropriate arrangements are in place to manage Market Risk arising as part of the activities undertaken by the Branch on a day-to-day basis.

The specific objectives of this policy are to:

- Document, at a high level, how the Branch manages Market Risk;
- Assign ownership and accountability for the maintenance of the Policy;
- Ensure understanding of Market risk and the controls in place within CNCBLB by relevant members of staff;
- Outline the intended approach to Trading Book activities should these become relevant in the future; and
- Support the implementation of the Branch's Risk Appetite as it applies to Market Risk management.

3 Ownership

The 'ownership chain' for the Policy is outlined below:

Document Owner	The Branch's Chief Risk Officer ("CRO") is responsible for the maintenance for this document. The CRO will also be responsible for reviewing the policy on an annual basis or more frequently as required. Any material changes to this document will be communicated to staff accordingly.
Oversight and challenge	Following review by the CRO, the Audit and Risk Committee ("ARCo") will review and challenge this policy at least annually or more frequently as necessary. Review outside the annual cycle could be triggered by: • Change in CNCBLC's strategy; • Change in the Branch's Control Framework; • Change in the Regulatory requirements; and/or • Change in HO's risk appetite. A recommendation for approval or otherwise is made to the Management Committee ("ManCo") following each review.
Approval	ManCo, based on a recommendation from ARCo, is responsible for final challenge and approval of this document.
Applicability	All members of staff, whether permanent (local hires and expatriate alike) or contractors must adhere to this policy. Escalation of any matters arising in respect of this should be via the individual's Head of Department or directly to the CRO.

4 Risk Management Framework

The Market Risk Policy is an integral part of the overall risk management framework and therefore must be read in conjunction with both the Risk Appetite Statement and Risk Management Framework, which is presented as follows:

CNCB (HEAD OFFICE)

HEAD OFFICE DELEGATED AUTHORITY
PRESIDENT CNCB LB

RISK APPETITE STATEMENT

RISK MANAGEMENT FRAMEWORK

RISK	PRIMARY RISK MANAGEMENT FRAMEWORK
CREDIT RISK	Credit Approval and Credit Risk Management Policy
MARKET RISK	Market Risk Management Policy
OPERATIONAL RISK	Operational Risk Management Policy Outsourcing Policy Business Continuity Management Framework New Products Approval Policy Conduct Risk Policy Framework
LIQUIDITY RISK	Liquidity Risk Management Policy

5 Three lines of defence

From a three lines of defence perspective the first line, the Financial Markets department and the Treasury, are consider the primary risk owners.

5.1 First Line of Defence

The Treasury team within Financial Markets will carry out all financial markets activities on behalf of CNCBLB. The financial market activities undertaken are primarily in the following areas:

- Trading on behalf of the Branch (for hedging and/or proprietary purposes);
- Trading for asset and liability management purposes when required; and
- Trading for client servicing purposes (Spot FX only).

In addition, the Finance and Accounting Department prepares financial reports including in respect of trading activities. In doing so, it is responsible for analysis of profits / losses on these positions which it reports to ARCo and ManCo periodically.

5.2 Second Line of Defence

The second line oversight and support are provided by the Risk department (“Risk”). Risk has day-to-day responsibility for overseeing the implementation of the Policy. It presents regular reports to ManCo on the Market Risk position of the Branch, limit utilisation and related issues.

Risk is also responsible for reporting the Market Risk position of the Branch to HO through the functional ‘dotted’ line and ARCo reporting requirements.

5.3 Third Line of Defence

The third line is implemented through the Internal Audit function (which is an outsourced function) which conducts periodic assurance activities in respect of policy adherence as well as adequacy of the overarching Risk Management Framework.

6 Market Risk

6.1 Definition

Market Risk as defined by the Basel Committee on Banking Supervision is “the risk of losses in on- and off-balance sheet positions arising from movements in market prices, including interest rates, exchange rates and equity values”.

Market Risk arises from both banking and trading business.

The Branch aims to fully hedge its Market Risk from the Banking book and only a small amount of Market Risk is expected to arise from FX and interest rate trading and hedging activities by the Treasury.

Market Risk is managed by reference to a set of limits that are calibrated to ensure that the risks remain within the branch’s risk appetite as applicable to Market Risk.

6.2 Limit Structure

The ARCo proposes and periodically reviews Market Risk limits for the Branch. In proposing limits for ManCo approval ARCo considers the President’s delegated Authority from Head Office (“HO”) as expressed in the Risk Appetite Statement (“RAS”) as well as the strategic objectives and overarching budget of the Branch.

Based on these limits individual trader mandates will be derived for relevant individuals within the Treasury. No members of staff other than those Treasury staff granted a specific trader mandate are authorised to transact any trades for the Branch and the President has the right to veto any transaction they do not consider in line with RAS or the strategy of the Branch.

The key Market Risk factors faced by the Branch include the following:

- Foreign exchange (“FX”) risk
  FX risk refers to the risk of on and off-balance sheet businesses of a bank incurring losses due to unfavourable changes of exchange rates; and
- Interest rate (“IR”) risk

IR risk refers to the risk of losses to overall earnings and economic value of bank accounts resulting from unfavourable changes in factors such as interest rate and maturity structure, including re-pricing risk, yield curve risk, benchmark risk and option risk.

CNCB LB shall continuously refine its monitoring process to ensure that all material market risks receive adequate attention and are addressed appropriately. The Risk department, with Finance and the Asset & Liability Committee (“ALCO”) shall be responsible for monitoring the Market risk profile of the Branch. Market risk reporting shall be reported daily by Finance to the Senior Management.

Stop Loss Limits

Finance Department will independently monitor the actual P&L against the USD 250,000 cumulative loss limit on a daily basis. The limit covers all products traded by Treasury and will be an aggregated net P&L, this will be circulated to senior management daily.

Any significant loss by a specific product may also be investigated by Finance Department. If a loss limit is actually breached (or in the judgment of the Finance Department that a loss limit is likely to be breached) then a report of the actual (or probable) breach will be sent to the Head of Financial Markets in order to develop a strategy and recommendation to ALCO as to how the risks should be managed.

The Head of Financial Markets will in consultation with the Vice President set loss limits at various sub-desk levels such as book or a trade, if required.

6.3 Market Risk Measurements

Market Risk is considered in respect of FX and IR exposures which are measured and monitored on a periodic basis. The Risk Appetite Statement sets the limits for Market Risk exposure (see **Appendix A**).

6.3.1 FX Risk

Foreign exchange risk refers to the risk of on and off-balance sheet businesses of a bank incurring losses due to unfavourable changes of exchange rates. The Branch will measure foreign exchange risk mainly through the analysis of foreign exchange exposures that consist of trading and non-trading exposures, including trading exposure that mainly results from the position in foreign exchange trading and non-trading exposure that mainly arises from foreign currency capital and foreign currency profit.

The tolerance levels with respect to market risk are as follows:

- Open FX positions (end of day) must not exceed $2mn equivalent;
- Open FX positions (intra-day) must not exceed $10mn equivalent;

No trading on behalf of customers other than in respect of Spot Foreign Exchange (“FX”) will be permitted.

6.3.2 Interest Rate Risk

The Branch’s exposure to Interest Rate Risk will be measured on a daily basis. The Branch uses a ‘gap’ approach to measure its Interest Rate Risk in Banking Book, (“IRRBB”) exposure.

The interest rate gap is determined as the maximum net position of interest earning assets and interest paying liabilities utilising actual maturity or maturity for interest rollover whichever is earlier.

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<u>Gapping Limits</u> - Interest rate gapping limits are set in order to control CNCBLB’s exposure to the interest rate risk arising from its business activity and restricts the re-pricing risk over various maturity buckets. The degree to which CNCBLB would be exposed to interest rate risk is identified through gap analysis using the principle of grouping together assets and liabilities that are affected by interest rate changes according to their maturity dates. Two different types of gaps may occur:

- A negative gap occurs when interest-sensitive liabilities maturing at a certain time are greater than interest-sensitive assets maturing at the same time. This results in a net exposure if interest rates rise by the time of maturity;

- A positive gap occurs if the amount of interest-sensitive assets maturing in a certain period exceeds the amount of interest-sensitive liabilities maturing at the same time. In this situation the firm will be negatively impacted if interest rates fall by maturity.

Traditionally banks borrow funds with short dated maturities and lend them over a longer term to take advantage of a positive yield curve. CNCB's funding is split between HO (evergreen and commercial funding) and customer call/fixed-term deposits; and depending on market conditions Treasury will hedge the interest rate risk by using interest rate swaps thereby locking in the margin and removing any interest rate risk. If not hedged perfectly, this creates a liquidity mismatch in the respective maturity buckets. In the expected gapping profile, the majority of interest rate risk is hedged, therefore, if interest rates rise or fall there will be minimal impact.

The Branch will manage its interest rate risk for the overall objective of observing the principle of prudent risk preference and achieving steady growth of both net interest income and economic value within the acceptable range of interest rate risk.

In addition, sensitivity analysis will be conducted regularly by Risk to understand the impact on net interest income based on ±200 Basis Points ("bps") shift in the curve.

7 Limit Breach Management

The Branch considers limit breaches as serious violations of the Branch's policies.

In the event of a limit breach, the responsible trader and other staff who come aware of the breach must report it immediately to the Head of Financial Markets and the CRO, who together will determine the necessary remedial action. Subsequently, Head of Human Resources and Administration will be consulted to determine if disciplinary action is required.

8 Market Risk Stress Testing Methodology

Market Risk exposures are measured and analysed by Risk not only for accuracy and completeness but also through stress testing.

Stress scenarios with various stress shocks for each risk factors (e.g. FX and IR) are developed by Risk in conjunction with ManCo. The results from these are presented and discussed by ARCo quarterly.

8.1 Stress Scenario Development and Reporting

Risk is responsible for carrying out the Market Risk stress testing.

Stress scenarios, which are developed in conjunction with ManCo, can be based on the Branch's business strategy, the macro-economic environment, idiosyncratic risk and either be based on historical stresses or hypothetical risks.

ARCo, is responsible for challenging and approving the scenarios at least annually. It must ensure that the Market Risk stress scenarios are adequately representing the risks faced by the Branch and that the stress shocks are appropriately severe to reflect an extreme but plausible downside case.

Risk will produce a report following conclusion of the stress testing setting out the results and implications thereof.

ManCo and ARCo may request ad-hoc and / or more frequent stress testing to be performed by the Risk department if necessary.

8.2 Action Plans

ManCo based on recommendations from ARCo will determine if any action is required to mitigate any potential risks identified by the stress testing. The actions may include, but are not limited to the following:

- Revising the limits for certain risks;
- Corrective actions (e.g. selling of certain assets); or
- Contingency plans (e.g. enhance monitoring for certain assets).

9 Trading Book and Banking Book

The Branch will not engage in trading activities on behalf of customers in such a manner as to operate a Trading Book. However, if in the future the Branch Strategy was to change to include such activities it is anticipated that the following broad framework would be applied.

9.1 Trading of Book Definition

The Trading Book comprises positions in financial instruments and / or commodities held either with trading intent or in order to hedge elements of the Trading Book. To be eligible for inclusion in the Trading Book, financial instruments must either be free of any restrictive covenants on their tradability or it must be possible to hedge them completely.

All positions in the Trading Book must be frequently and accurately valued.

9.1.1 Trading Intent

Positions held with trading intent are those held intentionally for short-term resale (holding period within 60 days); with the intent of benefiting from actual or expected short-term price movements; and / or to lock in arbitrage profit.

9.2 Definition of Banking Book

Any transaction that does qualify for inclusion in the Trading Book will be classified as a Banking Book transaction. The assets in the Banking Book are not expected to be traded on a frequent basis, if at all.

Any sales of Banking Book asset shall be approved by ManCo in advance. The following is a non-exhaustive list potential sale scenarios:

- An asset is very close to its maturity and change in market rates would not have any significant effect on its fair value;
- The sales are due to significant increase in risk of a Banking Book assets and ManCo has decided to reduce the risk exposures;
- Sales of loan to reduce exposures to target level or threshold, e.g. sales of the residual of originated loan; or
- The strategy of the Branch has changed at either branch or HO level.

9.3 Transfer between Trading and Banking books

The Branch will not allow asset transfers between the Trading and Banking Book under normal condition.

The initial classification of an asset shall be determined accurately according to the nature of the transaction. However, the Branch may allow a restricted number of transfers under exceptional circumstances. Any transfer must be proposed by ManCo.

The following is a non-exhaustive list where situation may warrant a transfer between the books.

- HO has significantly changed its risk appetite and requires the Branch to adjusts its exposures in the two books;
- Certain positions in Trading Book becomes illiquid and the market condition does not allow the sales of the assets; or
- The loans in the Banking Book which are converted to bonds by the borrower.

10 Review and Update of Policy

The Market Risk Policy shall be reviewed by the Risk at least annually or as directed by the ManCo, to reflect changes in the profile of risks or business activities, organisational or authority structures or new regulations relevant to CNCB LB management of market risk.

11 Appendix A – Market Risk Limits (Risk Appetite)

Foreign Exchange

Proprietary trading	Description
Currencies	USD, RMB, GBP, EUR
Intra-day limit	$10 million
Overnight limit	$2 million
Annual stop loss	$250,000

Interest Rate Risk

Tenors	Net Interest rate exposure / Total Balance sheet (maximum percentage)
Up to 8 days	100%
8 days to 1 month	60%
Up to 3 months	50%
Up to 6 months	40%
Up to 9 months	30%
Up to 12 months	25%
Up to 24 months	10%
Up to 60 months	0%